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C O N F I D E N T I A L SECTION 01 OF 03 KYIV 001916

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TAGS: [EFIN](#) [EREL](#) [ETRD](#) [PGOV](#) [PINR](#) [UP](#) [XH](#)
SUBJECT: NBU REFUSES TO CONCEDE ON NAFTOHAZ AND UKRAINE
BUDGET

REF: A. KYIV 1910
[1](#)B. KYIV 1878
[1](#)C. KYIV 1760

Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b) and
(d)

[1](#)1. (C) Summary. The National Bank of Ukraine (NBU) will continue to refuse to monetize government of Ukraine debt, despite a near empty GOU treasury and "psychological pressure" from Russia to make payments to Gazprom. In the NBU's view, the GOU will have enough resources via special IMF allocations to meet Naftohaz's obligations. Even without NBU support, other high-level sources said Ukraine would make its November 7 gas payment -- perhaps even early, in order to "calm down" Russia.

[1](#)2. Odds that the NBU would sign the latest IMF Letter of Intent (LOI) were "close to zero", even though the NBU would meet targets for net reserves and base money. The central bank was close to approving the transfer of assets and liabilities from troubled Ukrprombank to Rodovid, but it acknowledged that talks between Nadra and key foreign creditors remained off track. End summary.

NBU BALKS ON MONETIZING FOR NAFTOHAZ

[1](#)3. (C) NBU official spokesman and head of international relations Sergiy Kruglyk told the Charge on November 5 that the NBU would not monetize GOU debt for Naftohaz payments and Ukraine's 2009 budget deficit, despite possessing ample foreign reserves. Citing inflation concerns and the need for macroeconomic discipline, Kruglyk said there was "no possibility" the NBU would help the government meet its spending goals via monetization. The one financing tool the NBU had considered was giving state banks extra time to repay UAH 80 billion (\$9.75 billion) in outstanding credits, some of which were loans to aid Naftohaz with gas purchases. Such an extension could allow these banks to again finance Naftohaz gas payments.

[1](#)4. (C) Kruglyk noted that the Ministry of Finance had been declared Ukraine's "fiscal agent" and could draw on general and special allocations of IMF Special Drawing Rights (SDR) worth roughly \$2 billion from late summer. This mechanism would provide enough of a "buffer" for Ukraine to make its November 7 gas payment, even though the "government otherwise had no money." While Russia had applied "psychological pressure" on Ukraine to pay Gazprom, the NBU would not heed politically driven external or internal demands to monetize.

[1](#)5. (C) Separately, diplomatic contacts confirmed that the Ministry of Finance already had tapped SDR 300 million late on November 4, a sum that would facilitate Ukraine's November 7 payment to Gazprom. The IMF's resident representative Max Alier apparently indicated that the GOU's treasury account would be credited on November 6. Additionally, according to a British diplomat, the GOU planned to sell SDR 700-800 million after November 9 to meet November budget obligations and the December 7 payment to Gazprom.

[1](#)6. (C) Separately, Naftohaz spokesman Valentyn Zemlyansky told us that it was still unclear how Naftohaz would make the November 7 payment. Nonetheless, confirming what Presidential Envoy for Energy Security Bogdan Sokolovsky told us (Ref A), the Presidential Secretariat, Prime Minister, and Naftohaz had been working together to come up with a solution to the payment problem.

[1](#)7. (C) Ukraine's newly appointed Ambassador-at-Large for Energy Security Viacheslav Kniazhnytskyi told us that Naftohaz would make the payment in advance to "calm down" Russia. Independent energy analyst and former chairman of Uktransnafta's board Oleksandr Todiichuk likewise said that Naftohaz would pay on time. He noted that Naftohaz had started to sell the gas it had accumulated in underground storage this summer and was already receiving some compensation from domestic consumers.

[1](#)8. (C) Despite its slight revenue increase, Naftohaz would still need to rely on financing from state-owned banks or receive government support to make the November 7 payment, according to Todiichuk. He warned that the biggest risk for a possible cutoff was not whether Ukraine could make its

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monthly payment to Gazprom but the continued threat of

Russian penalties to Ukraine for its under-purchase of gas.

GOU HAS ADEQUATE TOOLS FOR BUDGET

19. (C) According to the NBU, 2009 and 2010 budget deficits could be financed with tools already at the GOU's disposal. Kruglyk said there was "plenty" of liquidity in the Ukrainian banking system. The GOU should rely on the domestic debt market to finance spending projects, such as for Euro 2012 infrastructure development and to combat the recent H1N1 outbreak. Nevertheless, Kruglyk later cautioned that the GOU should not issue securities with a 30% coupon, the rate offered by the Ministry of Finance on October 27 when it raised UAH 1 billion. Kruglyk said such rates would cause an unbearable debt burden.

110. (C) The NBU calculated that the social spending law figures (Ref B) presented by the Ministry of Finance were three times their actual cost, and that the President had signed a "feasible" law that would benefit the poorest of Ukraine's population. Nonetheless, 2010 would be a "very difficult" year for the new president. Kruglyk predicted that there would be no privatizations or new foreign directm(J_7ei5QQu8elxth IMF tranche, the NBU would have enough funds to cover balance of payments obligations.

NBU "HEALTHY"

112. (C) Kruglyk stated that the NBU was relatively "healthy" with total current reserves roughly \$27 billion and net reserves at \$16 billion. The NBU had met IMF targets for net reserves and base money.

113. (C) The NBU spokesman intimated that NBU governor Volodymyr Stelmakh would remain in office after formally retiring on December 18. President Yushchenko had already devised plans to appoint Stelmakh acting governor until the end of his presidential term, a move that would not require confirmation.

UKRPROMBANK AND NADRA UPDATE

114. (C) Kruglyk told us that NBU vice governor Anatoliy Shapovalov would authorize the transfer of Ukrprombank's assets and liabilities to Rodovid, assuming that the difference between assets and liabilities would be provided by the GOU in treasury bills (Ref C). Shapovalov planned to send official notification to the Cabinet of Ministers on November 5 or 6. (Note: Shapovalov had been the Charge's intended interlocutor, though allegedly he was summoned spontaneously by President Yushchenko. End note.)

115. (C) Nadra remained a more complicated case, namely because external creditors in the Coordinating Committee (CoComm) had yet to define a unified internal position vis-a-vis Nadra. According to Kruglyk, Nadra's restructuring efforts with export credit agencies and Eurobond holders had been successful. But the lack of CoComm agreement threatened overall restructuring talks. Nadra's temporary administrator Valentina Zhukovska had held talks in London on November 4 with CoComm representatives, while NBU banking supervisors continued negotiations with Nadra creditors on November 5. (Note: In October, the GOU relaxed its requirement for restructuring Nadra's external debt from 100% to 75%. Even this lower requirement has not been met, casting doubt on whether the bank will be recapitalized. End note.)

COMMENT

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116. (C) Using economically astute (and politically convenient) arguments, the NBU appears to be holding its ground on the monetization of government debt for Naftohaz and the budget deficit. This has prompted the Ministry of Finance to use its newly clarified "fiscal agent" status for SDR allocations to make quasi-sovereign gas payments.

117. (C) Options for the GOU's outstanding fiscal gap, totaling up to \$3.75 billion for the remainder of 2009, are more limited. Prime Minister Tymoshenko says the IMF program is now the only hope. Without NBU financing or IFI support, it is indeed difficult to see any way Ukraine will avoid payment arrears, anathema for Tymoshenko prior to the presidential election but just what her opponents seem to have ordered.

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